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No. 06-1463

In the

Supreme Court of the United States

ARNOLD M. PRESTON,

Petitioner,

v.

ALEX E. FERRER,

Respondent.

On Writ of Certiorari to the California Court of Appeal for the Second Appellate District

BRIEF AMICUS CURIAE OF PACIFIC LEGAL FOUNDATION IN SUPPORT OF PETITIONER

DEBORAH J. LA FETRA
TIMOTHY SANDEFUR
Counsel of Record
Pacific Legal Foundation
3900 Lennane Drive
Suite 200
Sacramento, California 95834
Telephone: (916) 419-7111
Facsimile: (916) 419-7747

Counsel for Amicus Curiae Pacific Legal Foundation

QUESTION PRESENTED

1. The Federal Arbitration Act (FAA) requires that disputes over the validity of a contract which includes an arbitration clause must be brought in the first instance before the arbitrator. *Buckeye Check Cashing Inc. v. Cardegna*, 546 U.S. 440 (2006). Such disputes may not be brought in the first instance before a state court, even where the dispute is over the validity of the whole contract. *Id.* at 446. Does the same preemption rule bar review by state administrative agencies as well as by state courts?

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INTEREST OF AMICUS CURIAE

Pursuant to Supreme Court Rule 37.3(a), Pacific Legal Foundation (PLF) respectfully submits this brief amicus curiae in support of the petitioner.[1]

PLF was founded more than 30 years ago and is widely recognized as the largest and most experienced nonprofit legal foundation of its kind. PLF litigates matters affecting the public interest at all levels of state and federal courts and represents the views of thousands of supporters nationwide. Among other things, PLF's Free Enterprise Project defends the freedom of contract, including the right of parties to agree by contract to the process for the resolution of disputes between them. To that end, PLF has participated as amicus curiae in many important cases involving the Federal Arbitration Act and freedom of contract in general, including *Hall Street Associates, L.C.C. v. Mattel, Inc.*, No. 06-989 (U.S. filed Jan. 12, 2007) (pending); *Cingular Wireless, LLC v. Mendoza*, 126 S. Ct. 2353 (2006); *Grafton Partners L.P. v. Superior Court*, 116 P.3d 479 (Cal. 2005); and *Gentry v. Superior Court*, 165 P.3d 556 (Cal. 2007). PLF believes its public policy experience will assist this Court in its consideration of the merits of this case.

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[1] Pursuant to this Court's Rule 37.3(a), all parties have consented to the filing of this brief. Letters evidencing such consent have been filed with the Clerk of the Court.

Pursuant to Rule 37.6, Amicus Curiae affirms that no counsel for any party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than Amicus Curiae, its members, or its counsel made a monetary contribution to its preparation or submission.

SUMMARY OF ARGUMENT

This case requires a simple extension of *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006). In that case, the Court held that the Federal Arbitration Act (FAA) requires disputes over the validity of a contract to be brought before the arbitrator, and not in state court (except where the dispute concerns the validity of the arbitration provision itself). Here, the question is whether disputes over the validity of a contract may be brought before a state administrative agency, or whether the authority of such agencies, like the authority of state courts, is preempted by the FAA. The answer is yes: administrative agencies—in this case, the California Labor Commission—act in many instances like state courts in determining the validity of contracts. To create a loophole in the *Buckeye* rationale that allows parties to escape their arbitration agreements simply by seeking review before administrative agencies would undermine the policy of the FAA, which is to require parties to abide by their agreements. That policy is rooted fundamentally in the freedom of contract—an essential principle of the American economy which must be upheld in this case.

ARGUMENT

I

THE FAA'S BASIC POLICY OF ENFORCING PARTIES' AGREEMENTS TO ARBITRATE WOULD BE UNDERMINED BY ALLOWING PARTIES TO CHALLENGE THE VALIDITY OF THE CONTRACT IN NON-ARBITRAL SETTINGS

The FAA was designed to guarantee the enforcement of contracts that call for arbitration, and to preempt state laws or common law that limited the enforceability of arbitration. Prior to the enactment of the FAA, some state courts had determined that they lacked power to order parties to abide by arbitration clauses. *See Southland Corp. v. Keating*, 465 U.S. 1, 18 (1984) (opinion of Stevens, J.). Even if the parties had agreed before the dispute arose that they would settle their disagreements through arbitration, one or the other party could later file a lawsuit in court, and the court would refuse to stay the proceedings pending arbitration or force the parties to submit to the arbitration as agreed. Breach of an arbitration agreement was thus effectively insulated from judicial review.

The American Bar Association responded to this problem by drafting federal legislation that incorporated arbitration into the federal judicial system, allowing disputes to be resolved by arbitration first, and then allowing those arbitration decisions to be confirmed by the federal courts. Congress adopted the Bar Association's proposal in the FAA. Arbitration agreements, Congress declared, "are purely matters of

contract, and the effect of the [FAA] is simply to make the contracting party live up to his agreement . . . . An arbitration agreement is placed upon the same footing as other contracts, where it belongs." H.R. Rep. No. 96, 68th Cong., 1st Sess. at 1 (1924). *See also* Christopher R. Drahozal, *In Defense of Southland: Reexamining the Legislative History of the Federal Arbitration Act*, 78 Notre Dame L. Rev. 101, 149 (2002) (quoting Rep. Graham):

> [t]his bill simply provides for one thing, and that is to give an opportunity to enforce an agreement . . . to arbitrate, when voluntarily placed in the document by the parties . . . . It does not involve any new principle of law except to provide a simple method by which the parties may be brought before the court in order to give enforcement to that which they have already agreed to.

See also Wharton Poor, *Arbitration Under the Federal Statute*, 36 Yale L. J. 667, 677 (1927) ("The principle of arbitration is, in substance, no more than allowing the parties to select and pay their own arbiter rather than to have one thrust upon them by the government.").

The Congress that enacted the FAA was motivated primarily by a concern for enforcing the contractual agreements of the parties, and the Court has repeatedly found that the FAA was designed "first and foremost . . . to enforce agreements into which parties had entered, and we must not overlook this principal objective when construing the statute, or allow the fortuitous impact of the Act on efficient dispute resolution to overshadow the underlying motivation." *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 220 (1985). *See also Moses H. Cone*

Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983) (recognizing "liberal federal policy favoring arbitration agreements").

The primary policy behind the FAA, therefore, is rooted in freedom of contract: to ensure that the agreements that parties make will ultimately be enforced. This freedom is effected by strictly enforcing agreements even where parties later regret the bargains they have made. As Professor Stephen J. Ware has noted, one of the primary benefits of arbitration is to ensure that a dispute-resolution mechanism is created prior to a dispute: "the social gains resulting from arbitration's lower process costs will not be realized nearly as often if an enforceable arbitration agreement can only be made after a dispute arises. Neither party is likely to agree, post-dispute, to arbitrate claims for which arbitration is expected to be less favorable to that party than litigation would be." Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements—With Particular Consideration of Class Actions and Arbitration Fees*, 5 J. Am. Arb. 251, 263 (2006). Enforcing arbitration agreements is nothing more than respecting the decisions the parties have made and were authorized to make. Allowing a party to escape his arbitration agreement imposes costs on the other party—costs that the other party consciously tried to avoid by negotiating and making an agreement.

Arbitration is widely recognized as cheaper and more efficient than judicial review. *See, e.g.*, Thomas S. Meriwether, *Limiting Judicial Review of Arbitral Awards Under the Federal Arbitration Act: Striking the Right Balance*, 44 Hous. L. Rev. 739, 758 (2007) ("Parties opt for arbitration in lieu of traditional

litigation in large part because arbitration offers a quicker and less expensive avenue for dispute resolution."). Parties who execute an arbitration agreement have thus made a bargain based on their costs and benefits. But more importantly, arbitration is a matter of freedom of choice, and this Court has recognized that the purpose of the FAA is not primarily to promote efficiency but to give effect to the parties' freedom of choice. *See Byrd*, 470 U.S. at 219-20. Unforseen alterations to any contract—such as allowing a party to back out of his agreement to arbitrate—both increases inefficiency and fails to protect the parties' freedom of choice. As this Court put it in *Baltimore & Ohio Sw. Ry. Co. v. Voigt*, 176 U.S. 498, 505 (1900), "the right of private contract is no small part of the liberty of the citizen, and . . . the usual and most important function of courts of justice is rather to maintain and enforce contracts than to enable parties thereto to escape from their obligation."

II

THE RATIONALE OF *BUCKEYE* SHOULD APPLY TO ADMINISTRATIVE AGENCIES AS WELL AS TO STATE COURTS

A. *Buckeye* Correctly Found That Litigants May Not Avoid Arbitration by Challenging the Contract as a Whole in State Courts

Contractual disputes, of course, will frequently be disputes over the validity, *vel non*, of the contract itself. An arbitrator is therefore frequently called upon to determine whether the contract itself is or is not validly formed and signed. To allow parties to evade

the arbitration agreement in any case where they challenge the validity of the contract itself would be to allow the parties to escape the arbitration that Congress specifically chose to enforce. Assuming the arbitration provision itself is valid, parties to a contract should not be able to escape their obligation to resolve disputes by arbitration by adding to their dispute a challenge to the validity of the contract as a whole and bringing that dispute in state court.

In *Buckeye Check Cashing*, this Court determined that where parties do not challenge the arbitration provision itself, but instead claim that the entire contract is void, the agreement to arbitrate is still enforceable, and the question of the contract's legality should "be considered by the arbitrator in the first instance." 546 U.S. at 446. This holding was based on the fact that the arbitration provision is a separate promise, severable from the rest of the contract's terms. *Id.* (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967)). Thus, enforcing the agreement to arbitrate—which was the FAA's goal—requires parties to abide by that agreement unless the arbitration provision itself is invalid. *Id.* at 445-46.

Moreover, allowing a party to evade the arbitration requirement by alleging a contract as a whole to be void would do significant damage to the FAA's policy of requiring parties to abide by their arbitration agreements. A party could allege a contract to be invalid, go to state court, and thereby "deny effect to an arbitration provision in a contract that the court finds to be perfectly enforceable." *Id.* at 448-49. In short, Congress intended, when enacting the FAA, to enforce the promises of parties who choose

to arbitrate so long as those promises themselves are valid, and to "withdraw the power of the states to require a judicial forum for the resolution of claims by which the contracting parties agreed to resolve by arbitration." *Southland Corp.*, 465 U.S. at 10. Assuming that the contract at issue falls within Congress' commerce power and the jurisdictional element included in the statute, *id.* at 11, a valid arbitration agreement in a contract is subject to enforcement even where the other terms of that contract, or its validity as a whole, are in dispute.[2]

The *Buckeye* decision was premised on the notion that the FAA's goal was to ensure nationwide enforcement of arbitration clauses in contracts. *See Byrd*, 470 U.S. at 219-20 (Congress' purpose in enacting the FAA was "to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate.").

> State court attempts to undercut the enforceability of arbitration agreements, such as that of the Florida Supreme Court in *Buckeye*, are just as detrimental to the uniform enforcement of arbitration agreements as was the federal "rule of equity" that prompted the passage of the FAA in the first place, or the anti-arbitration state legislation at issue in *Southland*.

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[2] These parties have not argued that this case involves wholly intra-state commerce, or addressed whether applying the FAA would be constitutional under such circumstances. *Cf. Jones v. United States*, 529 U.S. 848 (2000). Nor have the parties asked for the overruling of *Southland*'s conclusion that section 2 is applicable in state courts. *Cf. Allied-Bruce Terminix Companies, Inc. v. Dobson*, 513 U.S. 265, 284 (1995) (Scalia, J., dissenting).

Kirsten Weisenberger, *From Hostility to Harmony: Buckeye Marks a Milestone in the Acceptance of Arbitration in American Jurisprudence*, 16 Am. Rev. Int'l Arb. 551, 566 (2005). The FAA's preemption rule bars state courts from interceding in contracts that are subject to arbitration.

B. State Administrative Agencies Often Operate Essentially Like Courts in Reviewing Contract Disputes

The FAA was enacted at a time when the modern administrative state was still in its infancy. *See* G. Edward White, *The Constitution and the New Deal* 94-103 (2000). At that time, contracting parties who had a dispute were most likely to have that dispute heard before a state court. The FAA required parties to abide by their arbitration agreements instead of proceeding in state court. A modern administrative agency, however, frequently "acts as a legislative agency . . . [and] as an agency of the judiciary," *Humphrey's Ex'r v. United States*, 295 U.S. 602, 628 (1935), and contract disputes today frequently are addressed by administrative agencies which exercise this mixture of powers. Scott Brister, *The Decline in Jury Trials: What Would Wal-Mart Do?*, 47 S. Tex. L. Rev. 191, 195 (2005) ("Administrative agencies and commissions have thousands of employees resolving disputes about taxes, contracts, employment, construction, on-the-job injuries, and a host of other claims that were once tried to juries.").

Contractual review by administrative agencies has significant costs that would justify contracting parties' choice of arbitration over administrative review. "We know that administrative procedures, even the most informal are not cost-free. Professional

time is expensive, and the demands for it escalate rapidly as we move to ever more judicialized, adversary-type proceedings. Delay, too, is expensive . . . ." Judge Loren A. Smith, *Administrative Conference of the United States, 1981 Report* 2-3 (1981) (chairman's foreword), *cited in* Carl McGowan, *A Reply to Judicialization*, 1986 Duke L.J. 217, 229 n.68 (1986). At the federal level, the costs of administrative proceedings are so large that the Administrative Conference of the United States has recommended that agencies employ alternative dispute resolution, including arbitration:

> Federal agencies now decide hundreds of thousands of cases annually—far more than do federal courts. The formality, costs and delays incurred in administrative proceedings have steadily increased, and in some cases now approach those of courts. Many agencies act pursuant to procedures that waste litigants' time and society's resources and whose formality can reduce the chances for consensual resolution. The recent trend toward elaborate procedures has in many cases imposed safeguards whose transaction costs, to agencies and the public in general, can substantially outweigh their benefits.

Recommendations of the Administrative Conference Regarding Administrative Practice and Procedure (citing 1 C.F.R. § 305.86-3 (1986)), *reprinted at* 51 Fed. Reg. 25,641-01. The state of California similarly offers participants in administrative adjudications the option of proceeding via arbitration or other forms of alternative dispute resolution as a means of reducing

costs. *See* Cal. Code Regs. tit. 1, § 1202 ("The purpose of Alternative Dispute (ADR) is to provide *a less expensive* and more satisfying alternative to administrative adjudication without diminishing the quality of justice or the parties' right to a hearing." (emphasis added)).

Moreover, "[t]he use of administrative courts is not without its concerns, [including] . . . [a]gency 'capture.' " Carl N. Pickerill, *Note: Specialized Adjudication in an Administrative Forum: Bridging the Gap Between Public and Private Law*, 82 Notre Dame L. Rev. 1605, 1633-34 (2007). Agency capture is "the concept in political science literature that administrative agencies tend to develop biases toward their own regulatory clients." Joel P. Trachtman & Philip M. Moremen, *Costs and Benefits of Private Participation in WTO Dispute Settlement: Whose Right Is It Anyway?*, 44 Harv. Int'l L.J. 221, 240 (2003). Administrative agencies are likely to make decisions that will protect agency authority or promote other agency interests at the expense of the parties themselves. In fact, the legitimacy of the modern delegation of power to administrative agencies has been upheld in large part because the ultimate availability of judicial review is thought to prevent this kind of abuse in its worst instances. W. Michael Gillette, *Administrative Law Judges, Judicial Independence, and Judicial Review: Qui Custodiet Ipsos Custodes?*, 20 J. Nat'l Ass'n Admin. L. Judges 95, 101 (2000) ("[T]he need for judicial review is that it is a normal human response to being granted power to use that power to the fullest extent to which the power exists and (perhaps) a little beyond.").

Academic criticisms of private arbitration have often been predicated on the argument that arbitration offers an unequal forum that might benefit the wealthy and experienced at the expense of less influential parties, and that such proceedings may not offer the same procedural protections as traditional law courts. *See, e.g.*, Ann C. Hodges, *Dispute Resolution Under the Americans with Disabilities Act: A Report to the Administrative Conference of the United States*, 9 Admin. L.J. Am. U. 1007, 1097-98 (1996). But administrative agency hearings may also be unequal, expensive, informal, inefficient, or biased. *See, e.g.*, *Withrow v. Larkin*, 421 U.S. 35, 51 (1975) (concerns about administrative bias and inefficiency are "substantial . . . [and] not new . . . . Indeed, the growth, variety, and complexity of the administrative processes have made any one solution highly unlikely."). Private parties may legitimately worry that review by an administrative agency may not serve their needs. These parties should be free to agree to some other forum for dispute resolution, and to decide for themselves whether review by an arbitrator would be more effective, fair, and efficient. "There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate." *Volt Info. Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 476 (1989).

C. The FAA Precludes Review of a Contract's Validity by a State Administrative Agency

This Court has frequently found the authority of administrative agencies to be preempted by the FAA.

See, e.g., Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 28-29 (1991) ("[T]he mere involvement of an administrative agency in the enforcement of a statute is not sufficient to preclude arbitration."); *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220, 231 (1987) (requiring arbitration of disputes subject to jurisdiction of the Securities and Exchange Commission); *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 479-80 (1989) (same). In *Gilmer*, the Court held that while claims under the Age Discrimination in Employment Act are subject to review by the Equal Employment Opportunity Commission, arbitration agreements must nevertheless be enforced by bringing contractual disputes before the arbitrator, and not the Commission. 500 U.S. at 29.

Olde Discount Corp. v. Tupman, 1 F.3d 202 (3d Cir. 1993), *cert. denied sub nom. Hubbard v. Olde Discount Corp.*, 510 U.S. 1065 (1994), is one of the very few decisions to address the question presented in this case. There, the Third Circuit reviewed a case in which parties to a securities agreement fell into dispute which would otherwise have fallen under the jurisdiction of an administrative agency. The purchasers of the securities brought their dispute to the attention of the Delaware Division of Securities, *id.* at 204, and the Division began an investigation. When negotiations over the dispute failed, the seller sought to pursue arbitration in compliance with the securities contract. *Id.* at 205. The state, however, issued a notice that the seller would be subject to a hearing before the state securities commissioner. *Id.* The court found that the FAA required the parties to submit to arbitration, and not to state administrative review. "[I]f the Delaware securities commissioner pursues

rescission in the administrative proceeding," the court noted, the seller's "federal right to arbitration would be impaired, as the merits of the claim that the arbitration agreement reserves for an arbitral forum will be resolved administratively." *Id.* at 207.

The court noted that the FAA's "fundamental purpose [was] . . . to create 'a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary.'" *Id.* at 209 (quoting *Moses H. Cone*, 460 U.S. at 24). The court found that there was an actual conflict between the Delaware administrative mechanism for dispute resolution and the FAA, because the administrative remedy made it impossible to comply with the arbitration agreement, and because the state law served as an obstacle to the purposes of the FAA. *Id.* at 207. The administrative remedy would "adjudicate administratively the very same questions . . . that the [buyers] themselves could pursue only within an arbitration. In that regard, Delaware has interfered with [the seller's] right under the FAA to resolution of these issues through arbitration." *Id.* Thus the FAA precluded adjudication of the validity of the contract through administrative proceedings. *Accord, Dexter v. Prudential Ins. Co. of Am.*, No. 99-3137, 2000 WL 728821, at *3 (10th Cir. June 7, 2000) ("Clearly it was not contemplated that participation in administrative proceedings would operate to waive a contractual right to arbitration."); *Cf. Walton v. Rose Mobile Homes, LLC*, 298 F.3d 470, 474-75 (5th Cir. 2002) (FAA requires arbitration of disputes that would otherwise be reviewed by Federal Trade Commission, and therefore notice to the Commission is not required as it would be if parties sought review in court instead); *Davis v. O'Melveny &*

Myers, 485 F.3d 1066, 1082 (9th Cir. 2007) (dictum that "[a]rbitration is favored as a matter of policy regardless of whether it is in lieu of a judicial or administrative forum."). *Olde Discount* and these other decisions rightly recognize that the remedies available in administrative proceedings are not relevantly different from those available in judicial proceedings, and therefore that the FAA's goal of enforcing arbitration agreements should prevail even where the dispute is otherwise entrusted by state law to an administrative agency.

The analysis applied in *Olde Discount* applies with equal force to this case. There, the court pointed out that it was impossible to comply with both the administrative mechanism and the arbitration agreement, because the claims asserted before the administrative agency were the same as the claims that would have been raised before the arbitrator. 1 F.3d at 208 ("[T]he claims that the Delaware Division of Securities is pursuing . . . certainly would be subject to arbitration if pursued by the [buyers] themselves.").[3] This is also the case here: Ferrer's claim that the contract is invalid would be presented in both the administrative hearing and arbitration. Likewise, the *Olde Discount* court noted that "in any practical sense,

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[3] Although this Court found in *EEOC v. Waffle House, Inc.*, 534 U.S. 279 (2002), that the FAA did not preclude the resolution of a dispute by the Equal Employment Opportunity Commission, the EEOC in that case was pursuing its own remedy as a party in itself. The EEOC "[did] not stand in the employee's shoes" in that case, *id.* at 297. *Waffle House*, therefore, did not abrogate *Olde Discount* and does not apply to this case. The administrative agency in this case acts not as a prosecutor, or as an independent party, but only as a judicial forum to determine the validity of a contractual dispute between private parties. *Id.* at 294.

[the security seller] cannot simultaneously arbitrate its claims against the [buyers] and defend against the Delaware securities commissioner's pursuit of the rescission remedy in an administrative proceeding." *Id.* at 209. Although "in a physical sense [the seller] could be represented in two proceedings at once, the potential for actual conflict in that scenario is manifest," because if the arbitrator found that the buyer's claims were without merit, while the administrative agency affirmed them, "the results of the proceedings will be irreconcilable." *Id.* The same is true in this case: if the Labor Commissioner finds the contract invalid, the finding would be irreconcilable with an arbitrator's determination that it is valid. It is therefore "impossible to give effect to both the administrative . . . remedy and the federal right to arbitration." *Id.*

D. *Buckeye* Should Control This Case

Given that the FAA precludes initial review by a *federal* administrative agency, a straightforward application of the rationale of *Buckeye Check Cashing* and *Prima Paint* foreclose state attempts to interfere with arbitration by setting up administrative review procedures. In this case, review by the Labor Commissioner normally is required to determine the validity of a talent-representative contract. States may not interject their judiciary systems in disputes where the parties have agreed to arbitration, and the same policy applies to state administrative proceedings.

This is particularly compelling in this case, where review by the Labor Commissioner is not an *alternative to*, but is an *integral part of* state judicial proceedings in California. Under state law, the Labor

Commissioner's determination is subject to *de novo* review in state court. *Sinnamon v. McKay*, 191 Cal. Rptr. 295; 142 Cal. App. 3d 847, 850 (Cal. Ct. App. 1983). The administrative determination, therefore, *is* in all essentials a state judicial proceeding. *Buckeye Check Cashing* should therefore control the result.

CONCLUSION

The decision of the California Court of Appeal should be *reversed.*

DATED: November, 2007.

Respectfully submitted,

DEBORAH J. LA FETRA
TIMOTHY SANDEFUR
Counsel of Record
Pacific Legal Foundation
3900 Lennane Drive
Suite 200
Sacramento, California 95834
Telephone: (916) 419-7111
Facsimile: (916) 419-7747

Counsel for Amicus Curiae
Pacific Legal Foundation